

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
NICHOLAS PALADINO	:	DETERMINATION
D/B/A REM FOS AUTO &	:	
TRUCK SERVICE	:	DTA NO. 808197
	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period June 1, 1984	:	
through February 28, 1987.	:	

Petitioner Nicholas Paladino d/b/a Rem Fos Auto & Truck Service, 965 Remsen Avenue, Brooklyn, New York 11236, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1984 through February 28, 1987.

A hearing was commenced before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 28, 1991, thereafter adjourned and continued before Catherine M. Bennett, Administrative Law Judge, on November 19, 1991 at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York at 9:15 A.M., and reconvened on November 20, 1991 at 9:15 A.M. at the same location with all briefs to be submitted by May 21, 1992. Petitioner's post trial memorandum was submitted on February 24, 1992. The Division of Taxation's brief and petitioner's reply memorandum were received on April 15, 1992 and May 21, 1992, respectively. Petitioner appeared by Surkin & Handlin, P.C. (Dean L. Surkin, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

ISSUES

I. Whether petitioner has established that the audit methodology for the calculation of diesel fuel sales, gasoline sales, and repair sales was not reasonable and the tax as assessed was not reasonably calculated to reflect the taxes due.

II. Whether petitioner timely protested notice number S880106347K assessing the omnibus penalty.

III. Whether the omnibus penalty should be abated because underreporting was due to reasonable cause and not willful neglect.

IV. Whether the costs of litigation should be imposed against the Division of Taxation.

FINDINGS OF FACT

Petitioner, Nicholas Paladino, began operating a service station at 965 Remsen Avenue, Brooklyn, New York in 1961. The service station had two fuel pump islands and four repair bays. Although there were periods between 1961 and 1982 when Mr. Paladino performed primarily or solely repair work, in 1982 he resumed gasoline sales. In mid-1984, petitioner also added the sale of diesel fuel to his operations, having been advised by his former accountant that no particular license was needed to do so. The station operated between 8:00 A.M. and 6:00 P.M., Monday through Friday and, at most, one-half day on Saturday. The station remained closed every Sunday and holiday and was actually open fewer hours than competitors in the same geographic location. Petitioner operated the station himself with two or fewer employees at all times. In the regular course of his business, petitioner maintained a notebook with his accounts receivable, a business checkbook, deposit slips and bank statements. Although it is maintained that petitioner at one time had additional records, on the advice of his former accountant, petitioner discarded records other than those listed above (purchase invoices, sales invoices and other source documentation) after the business was sold in a bulk sale transaction on or about February 1, 1987.

The audit of petitioner herein was commenced as a result of information from another office within the Division of Taxation ("Division") that petitioner was selling diesel fuel which

the Division asserts was not being properly reported. An investigator approached petitioner's place of business and requested to see his license to sell diesel fuel. He proceeded to take a reading of petitioner's diesel fuel pumps during that visit in December 1985. Approximately three weeks later, another reading was taken and the results of the two readings were incorporated into a report. The field audit work papers contain a memorandum dated February 14, 1986 which summarized the result of the visits, showing total gallonage for the 19-day period of 52,666 gallons. Such report was the basis of the calculation of additional alleged unreported diesel fuel sales. There is uncertainty as to who actually read the pumps or whether the same person performed each reading. It is not clear which of the pumps located on the premises were read.

On May 21, 1986, the Division again visited petitioner's place of business. Another inquiry was made as to whether petitioner had continued to sell diesel fuel and petitioner advised that no diesel fuel was being sold at that time. This report indicated that three bays for auto repairs existed, but did not state the hours of operation or number of employees working with petitioner at that time. The file was thereafter recommended for audit.

By correspondence dated May 11, 1987, the auditor in this matter attempted to contact petitioner for purposes of a field audit. At that time a written request for petitioner's books and records was made. The appointment letter requested the following:

"All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, Sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records. Additional information may be required during the course of the audit"

The period under audit was June 1, 1984 through February 28, 1987. The auditor was referred to petitioner's former accountant, Louis DeStephano, for the purpose of acquiring books and records. The auditor testified the following books and records were not provided to him: the sales journal, the purchase journal, all bank statements, cash receipts, general ledger, register tapes, exemption certificates and deposit slips. The records that were provided included: bank statements from June 1984 through August 1985 and October 1985, Federal income tax returns

and sales tax returns. The auditor indicated he reviewed all books and records that were provided to him but came to a conclusion based on his review that the books and records were inadequate to proceed with a detailed field audit.

The auditor had also determined from documents provided by petitioner that there was a large disparity in reported gross receipts. Gross sales reported on New York State sales tax returns for the audit period were \$471,291.00, of which petitioner reported only \$61,438.00 as taxable. Gross receipts reported on Schedule C of petitioner's Federal income tax returns for the audit period were \$688,686.00. There was no explanation for the difference in reporting to the State and Federal governments provided at the hearing. The auditor had also determined that petitioner had been selling diesel fuel without being registered and without filing diesel returns.

The auditor divided his analysis into three different categories: gasoline sales, repair sales and diesel fuel sales. Having been provided with petitioner's sole proprietorship schedule of profits and losses, the auditor began his calculation using the figures for gross receipts from the 1984, 1985 and 1986 Schedule C's. He divided the 1984 gross receipts of \$286,534.00 by four to result in a quarterly figure of \$71,600.00 (rounded). He deemed \$71,600.00 as audited taxable gasoline sales for the periods June 1, 1984 through August 31, 1984 and September 1, 1984 through November 30, 1984. For the period December 1, 1984 through February 28, 1985, petitioner calculated the audited taxable gasoline sales using one-third of \$71,634.00¹ for the December sales, and two-thirds of a similarly-calculated quarterly figure of gross sales for 1985. Gross sales reported on petitioner's Schedule C for 1985 were \$240,112.00, resulting in a quarterly amount of \$60,028.00. Thus, for the quarter ended February 28, 1985, the auditor calculated sales at \$63,896.00 (one-third of \$71,634.00 plus two-thirds of \$60,028.00). Performing the same calculation for all quarters from June 1, 1984 to February 28, 1987 (factoring no sales for February 1987 due to the bulk sale) with Schedule C gross receipts for 1984, 1985 and 1986 as the basis for such calculation, the auditor concluded that total taxable

¹The auditor's testimony was provided in round figures. The actual field audit work papers indicate total audited gasoline sales of \$71,634.00.

gasoline sales for the period were \$688,686.00.

It was revealed by the testimony that all of petitioner's reported sales were allocated to calculate gasoline sales. The Division's auditor thereafter calculated amounts for diesel sales and repair sales and added such amounts to that which he calculated for audited taxable gasoline sales. The auditor's calculation of repair sales resulted from multiplication of 25% times the audited taxable gasoline sales of \$688,686.00 previously calculated. The auditor testified that based on his 18 years experience, the repair sales of a gasoline station are generally equal to approximately 25% of the station's gasoline sales. Thus the portion of the total repair sales attributable to gasoline sales was \$172,172.00.

The auditor next calculated audited diesel sales. Using the pump readings (the information provided in the investigator's memorandum) as a basis for his calculation, the auditor determined petitioner's sales of diesel fuel amounted to 100,000 gallons per month. He multiplied such gallonage by \$1.05 per gallon, yielding total diesel sales of \$2,415,000.00, covering the period June 1, 1984 through April 30, 1986 (23 months). The auditor indicated that since the investigator reported no diesel sales when he visited the premises in May 1986, the calculation ceased as of the previous month. The auditor thereafter calculated repairs attributable to diesel sales and calculated such repair work by multiplying audited diesel sales of \$2,415,000.00 times 5%, yielding additional repair sales of \$110,250.00. The 5% factor was said to also be based upon the auditor's prior experience in the industry. The total repair sales attributable to both sales of gasoline and sales of diesel in total were \$282,422.00 (\$172,172.00 + \$110,250.00). Thus, total audited taxable sales from all sources equalled \$3,386,108.00 as follows:

Gasoline sales	\$ 688,686.00
Diesel sales	2,415,000.00
Repair sales	<u>282,422.00</u>
	\$3,386,108.00

Audited taxable sales resulted in tax due of \$279,353.89. Petitioner was given credit for tax

paid of \$5,068.15, yielding additional tax due of \$274,285.74.

The Division issued notices of determination and demands for payment of sales and use taxes due dated January 6, 1988, covering the period June 1, 1984 through February 28, 1987, assessing additional sales tax due in the amount of \$274,285.74, plus additional penalty and interest of \$73,777.75 and \$91,891.42, respectively, for a total amount due of \$439,954.91.

Such notice provided the following explanation:

"Since you have not submitted your records for audit as required by Section 1142 of the Tax Law, the following taxes are determined to be due in accordance with Section 1138 of the Tax Law."

In addition a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to petitioner dated January 6, 1988 assessing the omnibus penalty in the amount of \$13,864.06.

A consent extending the period of limitation for assessment of sales and use taxes for the period June 1, 1984 through November 30, 1984 was executed to allow the determination of tax any time on or before March 20, 1988.

The auditor testified that with respect to his calculation of diesel sales, although he rounded the pro-rated pump readings to 100,000 gallons per month, a monthly calculation using the 20-day reading of 52,666,000 gallons would actually yield a total of 78,999 gallons per month. The auditor was unable to make reference to any price index from which he acquired the diesel price per gallon of \$1.05. He stated that he used an average going price of \$1.05 in the Brooklyn area where petitioner's business was located to arrive at such price. The auditor did not make reference to using a price per gallon for the years in question, but indicated by his testimony "that was the going price".

Post-hearing the Division's representative adjusted the calculation of additional tax due to reflect more accurately the utilization of the meter readings as described herein. The Division took 79,000 gallons per month and multiplied such amount by three to arrive at 237,000 gallons per quarter. The Division then multiplied the quarterly figure times \$1.05 per gallon to result in adjusted audited diesel sales of \$1,990,800.00 for the period June 1, 1984

through April 30, 1986, the period of time over which the Division asserts diesel sales took place. Since a portion of repairs was also calculated on the basis of diesel fuel sales (a factor of 5%), a pro rata adjustment was also made. Such adjustment resulted in adjusted audited diesel repair sales of \$99,540.00. Petitioner's audited total taxable sales as adjusted was reduced to \$2,951,198.00, yielding tax due of \$243,473.83. After applying tax reported by petitioner in the amount of \$5,068.15, adjusted assessed tax is \$238,405.68.

Petitioner's representative questioned the auditor with respect to his knowledge of the sales tax law relating to sales tax on motor fuel and diesel motor fuel, prior to a change in the law effective June 1, 1985. It was revealed that the sales tax law had been amended effective September 1, 1982, to provide that sales tax on motor fuel other than diesel motor fuel was to be collected by a registered distributor and was not the responsibility of the retailer. The auditor conceded the fact that the distributor was the party responsible for paying sales tax prior to June 1, 1985 not a person (such as petitioner) acting as a retailer. The auditor admitted that the audit work papers did not take this fact into account.

The auditor was questioned about the calculation of repairs using 25% of gasoline sales and 5% of diesel sales. Although the auditor admitted that the number of service bays, the hours of operation and the number of mechanics can vary from gas station to gas station, and that such factors will have a direct effect on the amount of repair sales a service station can handle, he claims to have taken those factors into consideration in applying such factors. The auditor could not refer to a survey or external trade index to support his estimates of 25% and 5%. Although the investigator's report indicated the number of bays in operation in petitioner's business, the auditor testified that he did not independently utilize this information. In addition the audit report does not refer to other service stations to which a comparison was made to substantiate the calculation and utilization of the factors used in the calculation of repair sales. Although the auditor believes he referred to the details of ten or twelve former audits to reach these factors, there is no reference in the audit work papers that indicates this was done.

The auditor conceded that after petitioner's accountant was not forthcoming with

sufficient records in accordance with his request, he did not thereafter make any attempt to contact petitioner directly.

The auditor testified further that based on the tax he calculated and assessed for gasoline sales (\$688,686.00), he computed a gallons-per- month equivalent in an attempt to show the reasonableness of the taxable sales as computed. The converted figures are as follows:

<u>Period</u>	<u>Gallons Per Month</u>
6/1/84 to 8/31/84	25,675
9/1/84 to 11/30/84	25,675
12/1/84 to 2/28/85	22,902
3/1/85 to 5/31/85	21,515
6/1/85 to 8/31/85	21,515
9/1/85 to 11/30/85	21,515
12/1/85 to 2/28/86	22,619
3/1/86 to 5/31/86	23,277
6/1/86 to 8/31/86	23,277
9/1/86 to 11/30/86	23,277
12/1/86 to 2/28/87	23,278

The investigative report submitted into evidence as part of the audit work papers dated May 21, 1986 to which reference has been made, indicates that gasoline was being sold at the following rates: unleaded gasoline 93.9, regular 85.9, and super unleaded 98.9, at that time. The report also stated that petitioner's station had three bays for auto repairs and eight pumps for fuel service.

The above calculation of gallons per month was accomplished by using audited gasoline sales per quarter as calculated by the auditor and dividing the same by \$.93, the average selling price of the three types of gasoline being sold by petitioner's station. For example, \$71,634.00 (gasoline sales for 6/1/84 to 8/31/84) divided by \$.93 resulted in a total gallonage for the quarter of 77,026, which when divided by three equals 25,675 gallons per month. He thereafter performed the same calculation for each of the succeeding quarters.

Thus, the auditor concluded that his calculation of gasoline sales was reasonable and had he utilized the average of 29,000 gallons per month as indicated by petitioner's expert witness (see, infra), the calculations of audited gasoline sales would have been significantly higher.

Petitioner provided testimony on his own behalf. Mr. Paladino, advanced in age, spoke

with a heavy, broken accent. Mr. Paladino's lack of formal education is reflected by the records produced at the hearing. He confirmed the physical layout of the business as well as the hours of operation, the fact that he never had more than one or two employees working for him at any given point in time, and that he conducted the business in a hands-on manner. He testified that he sold diesel fuel from mid-1984 until the last week in December 1985. He testified that he paid cash for the diesel fuel he purchased, receiving no purchase invoices from a man named Iggy, with whom he only spoke by telephone.

Petitioner introduced the testimony of Jerome Statham, general manager of the petroleum division at MPSI in Tulsa, Oklahoma. MPSI is a computer software company that specializes in demographics. Mr. Statham serves primarily major oil companies which utilize such service for the purposes of planning for new service stations, the modernization of existing stations or for closing stations. In the course of his business, Mr. Statham has had the opportunity to perform surveys of service stations and is personally familiar with Mr. Paladino's business. Mr. Statham had conducted a survey that included Mr. Paladino's service station located at 965 Remsen Avenue, Brooklyn, New York. An independent survey, unrelated to the audit herein, was done in 1981, 1986 and 1988. He indicated that a survey of this kind considers the physical layout of each property, its characteristics, its location, the brand of gasoline sold, its pricing posture, days and hours of operation and traffic patterns in the general location. Three methods are used to determine the amount of sales done by a particular service station encompassed by the survey: a personal interview, a meter reading and/or a supplier's verification of volume. The study performed in 1981, of which petitioner's business was a participating unit, used a meter reading which resulted in estimated gallons of gasoline sales per month at 26,000 for petitioner's business. In 1986 and 1988, based on the same information available to MPSI through the process of interviewing, the gallons of gasoline sold each month were estimated at 29,000 gallons. It was Mr. Statham's expert opinion that the sales volume of gasoline during the period 1984 through 1987 ranged between 26,000 and 29,000 gallons per month.

One of the additional factors noted by such a survey is whether or not the facility is also selling diesel fuel. Mr. Statham indicated that diesel sales can have a positive or negative effect on gasoline sales. In the three surveys done, it was estimated by MPSI that the diesel sales volume was in the range of 2,000 to 4,000 gallons per month. Mr. Statham stated, unequivocally, in his opinion it would have been impossible for petitioner's service station to sell 100,000 gallons of diesel each month (the amount originally used by the auditor) since the physical layout of the facility and the traffic patterns were such that this station was not capable of handling such high-volume diesel sales. For instance, it was noted that the diesel pumps were located on the same island as gasoline pumps, thereby representing competition for the usage of those pumps during the day. Other pumps were blocked by the diesel purchaser because of the nature of the large vehicles making such purchases. Mr. Statham noted that the study performed encompassing the three years mentioned was for the purpose of determining gasoline sales and that, although an estimate of diesel sales is made in the course of the preparation of such report, the emphasis of the report is geared to the accuracy of gasoline sales.

In an attempt to show a pattern of sales which was comparable to the estimate by Mr. Statham's surveys, though noting the information preceded the audit period, petitioner introduced two items of correspondence indicating gallons of gasoline purchased. The first, a letter from the Department of Energy, indicated petitioner purchased 2,647,965 gallons of refined (Shell) product between March 6, 1973 and January 27, 1981 (95 months) yielding 27,873 average gallons per month. The second item of correspondence was from Alcor Petroleum Corporation and it stated that although its records were no longer retained to substantiate such purchases, the recollection of the field supervisor servicing petitioner's station during 1982 and 1983 was that he purchased between 25,000 and 28,000 gallons of gasoline per month.

Petitioner provided the testimony of Giuseppe DiGirolamo, a former employee of petitioner's service station. He commenced working for Mr. Paladino in February 1986 and worked for him throughout that year. Mr. DiGirolamo testified that petitioner did not sell diesel

fuel during 1986. He testified that there were two islands housing the gasoline pumps with three pumps on each island and, at the time of his employment, the center pump was not in operation on both islands. He verified that the service station was open five days a week from the hours of 8:00 A.M. to 6:00 P.M., on Saturday until approximately 12:00 P.M. and never on Sundays or holidays.

Petitioner also presented the testimony of Alfio Fred Paladino, petitioner's son. He confirmed that petitioner's business was a self-run, hands-on type of operation. Alfio was a mechanical engineer by education and once he had completed his schooling had little involvement with the service station. His involvement while he was with the station, from mid-1984 until July 1985, was primarily with respect to the pumping of gas and office work. He testified that it would have been impossible to serve 45 diesel purchasers per day given the station's layout restrictions and the time needed to serve such vehicles.

James Mammome, a certified public accountant, began assisting petitioner with the issues of this case when his former accountant failed to respond to requests by the Division for financial records. He examined petitioner's tax returns and the records which still existed in petitioner's possession for the audit period. Because there were no source records, Mr. Mammome first reconciled petitioner's checkbook to his bank statement for every month from January 1984 through March 1987. He made a comparison of cash receipts from the bank statement to the sales reported on the Federal income tax return. Mr. Mammome instructed Mr. Paladino to calculate from his deposit slips a breakdown of the gasoline, diesel and repair sales separately for each of the periods in question. In separate testimony, Mr. Paladino indicated that he made contemporaneous recordings of a breakdown of the deposits after he received his customer copy of the deposit slip at the time of deposit. Thus, from the deposit slips, and in correlation with the deposits per bank statements, Mr. Mammome reconstructed a cash receipts journal separating receipts into sales of gasoline, diesel and repairs. In the case where a deposit slip was missing, but a deposit appeared on the bank statement, Mr. Mammome attributed such deposit to each of the three categories based on subsequent months and a pro

rata allocation representative of previous deposits. He determined by such analysis that gasoline sales were approximately 71% of total sales and diesel and repair sales were 19% and 10%, respectively. His method of allocation and reconstruction of cash receipts in each of the categories yielded the following: total gasoline sales for the audit period were \$409,696.64; total diesel sales were \$92,967.36; and repair sales totalled \$107,789.35. Diesel sales were calculated from June 1, 1984 through the quarter ended February 28, 1986. In his calculation of gross taxable sales, Mr. Mammome did not consider gasoline sales as being taxable since he believed the distributor was responsible for gasoline taxes during the period June 1, 1984 through February 28, 1987. In addition, Mr. Mammome verified his results by analyzing checkbook expenditures recording total auto parts purchases and comparing the sale to total repairs on a monthly and quarterly basis. He concluded that the auto parts purchases were generally less than the amounts generated from such repair sales and thus there was a correlation between such purchases and that which he had calculated as gross receipts from repairs.

Mr. Mammome thereafter added diesel sales and repair sales for total gross taxable sales of \$200,756.71. He calculated the unreported difference at \$134,250.56, resulting in a sales tax deficiency of \$10,231.57.

Mr. Mammome reconstructed the records on the basis that all sales were deposited into petitioner's bank account and conceded that if all cash and charge receipts were not deposited, such recapitulation would be understated. To support the reasonableness of the fact that sales receipts were reported, Mr. Mammome testified that he reviewed checks written to companies from which purchases of gasoline and diesel product were made and indicated that although he could not verify gallons purchased, petitioner appeared to be making purchases reasonably comparable to the sales so recorded from deposits. The accountant also testified that the information on the deposit slips, purportedly contemporaneous recordings of the sales by Mr. Paladino, could not be verified by any source documentation.

Petitioner timely challenged the notice of determination asserting tax of \$274,285.74

(Notice No. S880106346K). At the Bureau of Conciliation and Mediation Services conference, the notice was thereafter sustained by a Conciliation Order dated February 23, 1990. Petitioner thereafter filed a petition challenging two notices of determination, the one sustained by the conciliation conference as well as a second notice assessing the omnibus penalty (Notice No. S880106347K). The Division submitted into evidence the affidavit of the supervising conciliation conferee indicating that the Bureau of Conciliation and Mediation Services bears no record of ever receiving a request for conciliation from petitioner with regard to the notice of determination assessing the omnibus penalty. Petitioner submitted into evidence a copy of correspondence dated January 12, 1988 addressed to the auditor in this matter from petitioner advising him that petitioner did not agree with the assessment of the omnibus penalty, referring specifically to the same notice number contained on the penalty notice and demanded a hearing thereon.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner asserts that the Division's calculation of diesel fuel sales, gasoline sales and repair sales were incorrect and arbitrary. Petitioner initially argued that the diesel fuel calculation was arbitrary since it was based upon an arithmetic mistake by the auditor which the Division has recognized in its adjustment (see Finding of Fact "11"). With regard to the calculation of diesel fuel sales, petitioner claims the price per gallon utilized by the auditor was erroneous; the Division's calculation is blatantly impossible given the size, hours and manner of operation of the business; and diesel sales did not take place during the entire period in question. Petitioner takes issue with the auditor's use of Federal income tax returns to project gasoline sales and considers such calculation erroneous, having not taken into account a provision of the Tax Law prior to June 1, 1985. Petitioner asserts the arbitrary calculation of repair sales since the projection did not take into account the hours of operation, the number of service bays available or the number of mechanics employed by petitioner. Petitioner claims to have presented sufficient documentation to establish the correct amount of tax due and also asserts that the omnibus penalty should be omitted since such underreporting was due to

reasonable cause and not willful neglect. In addition, petitioner claims that his challenge to the omnibus penalty was timely.

The Division asserts that petitioner has not met his burden of proof by clear and convincing evidence of the assertions he makes in this matter. Since petitioner failed to maintain and provide the auditor with adequate books and records, an audit based on estimates was allowable. The Division also asserts that petitioner has failed to prove by clear and convincing evidence that the audit method was unreasonable or the tax asserted erroneous. Finally, the Division asserts that petitioner has failed to show reasonable cause for abatement of penalty and that reliance on an accountant's advice will not relieve the taxpayer of such responsibility.

CONCLUSIONS OF LAW

A. Tax Law § 1135 states that every person required to collect taxes "shall keep records of every sale, . . . and of all amounts paid, charged or due thereon Such records shall include a true copy of each sales slip, invoice, receipt, statement or memorandum" upon which the sales tax shall be separately stated. Upon audit, the Division must make an explicit request for taxpayers' records (see, Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858), and review the records available (Matter of King Crab Rest. v. Chu, 134 AD2d 51, 522 NYS2d 978; Matter of Max Service Center, Tax Appeals Tribunal, September 29, 1988). Where the taxpayer's own failure to maintain proper records prevents exactness in determination of sales tax liability, exactness is not required (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 78, lv denied 44 NY2d 645, 406 NYS2d 1025), and estimates by the Division regarding a taxpayer's liability are acceptable as long as rationally based (see, Matter of Grecian Square v. State Tax Commn., 119 AD2d 948, 501 NYS2d 219; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989). In addition, the Division must find a taxpayer's records inadequate before resorting to external indices to conduct an audit (Matter of Chartair v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41). The Division's resort to external indices to estimate the tax due is justified when a taxpayer does not have the records

necessary to verify his taxable sales (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552). It is an auditor's duty to select an audit method which would reasonably reflect the taxes due (see, Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869; Matter of Bernstein-On-Essex St., Tax Appeals Tribunal, December 3, 1992), although exactness in the outcome of the audit is not required (Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454; Matter of Cinelli, Tax Appeals Tribunal, September 14, 1989). Once an appropriate audit has been performed, the resulting assessment by the Division is presumed correct (Matter of Cousins Service Station, Tax Appeals Tribunal, August 11, 1988). The Division does not have the burden of proving the propriety of its assessment (Matter of Blodnick v. State Tax Commn., 124 AD2d 437, 507 NYS2d 536). Petitioner has the burden of proving by clear and convincing evidence that the audit method chosen was unreasonable or the audit result was inaccurate (Matter of Sol Wahba v. State Tax Commn., 127 AD2d 943, 512 NYS2d 542; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

B. The question raised in this matter is whether petitioner has established that the audit methodology was not reasonably calculated to reflect the taxes due. The audit methodology with respect to the component parts of petitioner's business differed in each case and will be addressed accordingly. The Division has established that a request for petitioner's books and records was made and it is conceded by petitioner that substantial portions of such records were lacking. Although petitioner explained that he merely followed the erroneous advice of his former accountant, it is somewhat of a mystery why petitioner would not have made an additional inquiry seeking advice regarding the retention of proper books and records, having been engaged in business transactions for more than 25 years. It is petitioner's failure to have maintained proper records which allows the Division an opportunity to estimate petitioner's liability and also allows the Division the latitude to resort to external indices.

C. With regard to the calculation of gasoline sales, the Division began its calculation with the amounts representing gross receipts on petitioner's Schedule C sole proprietorship

schedule of his personal income tax return. Those receipts for the three years totalled \$688,686.00. For some unexplained reason, petitioner reported over \$200,000.00 less as gross sales on his New York State sales tax returns, of which petitioner reported only \$61,438.00 as taxable. Again, no explanation was provided. The Division had reason to believe that diesel sales were unreported and petitioner could not produce documentation to show otherwise, though a reconstruction of petitioner's records indicates petitioner's position that he reported the same in gross receipts. Petitioner argued that it was improper for the Division to allocate total Federal gross receipts only to gasoline sales since that amount represented sales of repairs as well as diesel fuel. The Division's choice of utilizing gross receipts as a starting point and attributing the same entirely to gasoline sales was reasonable in light of all the circumstances. The auditor calculated a gallons-per-month equivalency in accordance with his use of gross receipts in the amount of \$688,686.00 for the audit period in order to show the reasonableness of the resulting tax. Finding of Fact "15" shows the results of such calculation. His gallon-per-month equivalency falls right in line with what petitioner claims to have been selling and, in fact, is slightly less. Petitioner's expert testified that within a small margin of error petitioner was selling between 26,000 and 29,000 gallons of gasoline per month for the years in issue. Petitioner introduced into evidence two items of correspondence indicating purchases between 25,000 and 28,000 gallons per month. Although such correspondence referred to periods prior to the audit period, it certainly indicates a propensity to sell at a certain level. Thus, the Division's use of the estimated amount of \$688,686.00 attributable to gasoline sales is upheld.

D. Petitioner asserted that he was not responsible for collection of sales tax during a certain point in time when the obligation to do so was placed upon the distributor. In Matter of Fourth Day Enterprises (Tax Appeals Tribunal, October 27, 1988), the Tribunal reviewed the legislative history of the tax laws in issue. Prior to September 1, 1982, sales tax on motor fuel was imposed and required to be collected on each gallon of gasoline sold at retail service stations (Tax Law former § 1111[d], [e]). Beginning September 1, 1982 (L 1982, chs 454 and 469) and during the period in issue here, June 1, 1984 through May 31, 1985, the retail sales tax

on motor fuel was collected on sales by distributors to nondistributors such as retail service stations since Tax Law former § 1101(b)(4)(ii) provided that "a sale of automotive fuel [including motor fuel] by a distributor is deemed to be a retail sale." This provision of the Tax Law defined distributor as "any person, firm, association or corporation, who or which imports or causes to be imported into the state, for use, distribution or sale within the state, any motor fuel . . .", and was in effect until its revision took effect on June 1, 1985. The tax was thus imposed generally at a higher point in the distribution chain than the point of sale by the service station. Under the tax collection system in place covering that portion of the audit period between June 1, 1984 and May 31, 1985 the retail sale had occurred for sales tax purposes when the motor fuel was sold by the distributor (see, Matter of Gasit, Inc., Tax Appeals Tribunal, July 19, 1990, confirmed 171 AD2d 325, 576 NYS2d 402, appeal dismissed 79 NY2d 1040, 584 NYS2d 448). The Division argues in this regard that since petitioner had no source records to substantiate the number of gallons purchased or gallons sold or the amount of tax paid to suppliers, petitioner could not be given a credit for taxes paid to his supplier, if any. Petitioner did not seek a credit in this case; he merely sought for the Division to place responsibility on the party from whom the Division should properly seek taxes if such are due. Petitioner was not under obligation during the period June 1, 1984 through May 31, 1985 to collect sales tax as a retail service station operator. The auditor concedes so in his testimony and admits that there was no reduction for such provision considered in his calculations. Thus, total taxable gasoline sales must be adjusted downward by \$267,192.00 as calculated on a quarterly basis by the auditor (Audit Workpaper P7).

E. Petitioner also challenges the reasonableness of the Division's calculation of diesel fuel sales. Petitioner admitted that he was purchasing diesel fuel from an unknown source with cash and was never given purchase invoices or any other type of source documentation. Justifiably, the Division placed the reporting status of such fuel sales in question. The Division asserts an investigator from another unit took meter readings and calculated approximately 79,000 gallons per month of diesel fuel sold by petitioner. Although I would generally find a

meter reading to be a reliable source of information, the evidence in this matter raises certain questions. It is unclear whether the same investigator performed both readings and, although the documentary evidence indicates two pumps were read, it does not specifically identify which of the pumps on petitioner's premises were being referred to. Those facts coupled with the vast difference between the Division's calculation and an estimate by petitioner's expert are sufficient to cast a shadow on the result of the Division's audit methodology with respect to diesel sales. Petitioner's expert testified that an estimate of diesel fuel sales is incorporated into its survey report because he deems it relevant to the analysis whether diesel fuel sales act in a competing manner with the sale of gasoline. Interestingly, the expert's report also indicates that the average diesel volume for stations competing in the same trade market survey location as petitioner's station was 5,000 gallons of diesel fuel per month. In addition, petitioner's son testified that the speed at which the gasoline pumps could pump fuel was approximately five gallons per minute. The diesel fuel pumps operated at a slower rate because the fuel was heavier and needed more pressure. He testified that the average purchase by a diesel fuel customer, i.e., a truck or bus, was 40 to 50 gallons per stop. It would take at least 15 minutes for the transaction to be completed. If one utilized the Division's estimate of 79,000 gallons per month and divided the same by 22 days per month, the time it was testified that petitioner's business was open (5½ days per week), the Division is asserting that petitioner was selling nearly 3,600 gallons of diesel fuel per day. If that figure is divided by 45 gallons, the average amount of diesel fuel pumped by a tractor-trailer or bus, petitioner would have had to service 80 vehicles each day for this to be a reasonable calculation. When petitioner's son was questioned about the reasonableness of servicing 45 trucks in one day, he indicated it would be impossible because a truck would block off an entire island of pumps such that other cars or trucks would be precluded from stopping at that point. Given the hours of operation, such an estimate was not a reasonable calculation. Petitioner's current accountant offered a reconstruction of petitioner's sales and computed diesel sales at \$92,967.36. If such an amount is divided by \$1.05 per gallon, an amount which was suggested as the going rate during the course of the

hearing, gallons sold during the audit period would approximate 88,540. If 88,540 is divided by 21 (the number of quarters contained in the period June 1, 1984 through February 28, 1986, the period of time covered by the diesel sales reconstructed by petitioner), the average number of gallons of diesel fuel sales per month is approximately 4,200. Given all of the evidence in this matter, petitioner carried his burden of showing the unreasonableness of the audit result. Tax assessed on diesel sales for the audit period of \$92,967.36 shall be imposed.

F. The Division asserts that much of petitioner's proof by way of testimony is self-serving and cites authority indicating that self-serving testimony is not sufficient to carry petitioner's burden of showing the unreasonableness of the audit methodology. The Division cites to Matter of Petroleum Sales and Serv. v. State Tax Commn. (98 AD2d 882, 470 NYS2d 865), which makes reference to the absence of direct proof of the item in issue, as well as proof from a qualified expert. In this matter, a qualified expert not only existed but a survey performed by him in the ordinary course of his business took place at a date which preceded and was independent from the audit. The expert established that the gasoline and diesel fuel sales for petitioner's business fall within a certain range of business activity and the fact that such a survey was conducted at a time when petitioner's business activities were not being scrutinized gives such report and testimony a high degree of credibility.

G. With respect to the calculation of repair sales, the auditor estimated, based on his 18 years experience, that in general, repair sales are equivalent to 25% of gasoline sales in a station that performs such services, and attributes 5% of its diesel sales to services for repairs. The auditor conceded that the number of service bays, the hours of operation and the number of mechanics can vary from station to station and that such factors have a direct effect on the total amount of repair sales. He claims to have taken those factors into consideration as well as performed a review of 10 or 12 former audits to reach the factors of 25% and 5%. The audit methodology employed by the Division with respect to repair sales does not indicate that the auditor reviewed gas stations which were substantially and materially similar. The record is absent any evidence that describes any of the stations so reviewed. There is no reference in the

auditor's log to having done so. The record does not indicate any computation utilizing the number of hours or bays, etc., which are key and directly effect the ultimate sales of repairs. The Tax Appeals Tribunal has held that the record must contain information identifying the external index used by the Division to establish a rational basis for the audit methodology employed (Matter of Basileo, Tax Appeals Tribunal, May 9, 1991; Matter of Fashana, supra). The Division is required at the hearing, through witnesses or documents, to respond meaningfully to inquiries regarding the nature of the audit performed. Such information has been deemed necessary by the Tribunal to provide the taxpayer with an opportunity to meet its burden of proving such methodology unreasonable (Matter of Basileo, supra; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991). As to the repair sales, the Division was unable to show that this portion of the audit had a rational basis. Petitioner, in the alternative, indicates repair sales by reconstruction of records of \$107,789.35. Based on the number of months in the audit period, this amount would equate to slightly under \$3,400.00 in repair sales per month. This amount is accepted as petitioner's repair sales.

H. Tax Law § 1145(a)(1)(vi) imposes the omnibus penalty and states, in pertinent part:

"Any person required by this article to file a return, who omits from the total amount of state and local sales and compensating use taxes required to be shown on a return an amount which is in excess of twenty-five percent of the amount of such taxes required to be shown on the return shall be subject to a penalty equal to ten percent of the amount of such omission If the tax commission determines that such omission was due to reasonable cause and not due to willful neglect, it shall remit all of such penalty."

Pursuant to the authority noted above, the omnibus penalty is properly imposed since it has been determined that petitioner omitted an amount greater than 25% of the amount of tax required to be shown on the return, unless petitioner carries the burden of proving that underreporting was due to reasonable cause and not willful neglect. Petitioner has failed to meet such burden.

Although it is clearly possible that petitioner's former accountant erroneously instructed him to discard records, petitioner was a man with business experience of more than 25 years and, as a result of such experience, had reason to know that such records were crucial should his business operations ever be under scrutiny after the sale of such business. It was a brief period of time

between the sale of the business and the issuance date of the initial audit appointment letter during which petitioner claims to have discarded a significant portion of his records. In light of these facts and those discussed above, petitioner is not excused from such penalty.

I. The timeliness of the protest of Notice No. S880106347K is not addressed herein insomuch as the penalty is upheld and adjusted in accordance with the tax as due.

J. The Rules of Practice and Procedure of the Tax Appeals Tribunal do not make provision for the award of costs of litigation against the Division. Even if such a provision existed, I see nothing in this case which would warrant granting such an award.

K. The petition of Nicholas Paladino d/b/a Rem Fos Auto & Truck Service is hereby granted in accordance with Conclusions of Law "D", "E" and "G"; the notices of determination and demands for payment of sales and use taxes due dated January 6, 1988 are hereby modified in accordance therewith; credit shall be given for taxes paid by petitioner and, in all other respects, the petition is hereby denied.

DATED: Troy, New York
March 4, 1993

/s/ Robert F. Mulligan
ADMINISTRATIVE LAW JUDGE